



BOARD ADOPTED POLICIES

POLICY NUMBER: 2.13.100

EFFECTIVE DATE: 7/1/03

TITLE: Deferred Compensation Program and
Judicial Retirement Account

SUPERSEDES: 2.13.100, 7/18/02, and
2.12.100, 7/18/02

BOARD ADOPTION: 7/18/02

APPROVED: *Joseph A. Deen*

BACKGROUND:

Deferred Compensation Program (DCP)

Revised Code of Washington (RCW) 41.50.780 states that the assets of the DCP are held in trust for the exclusive benefit of the participants and names the Washington State Investment Board (WSIB) as trustee of the assets. The WSIB has the sole authority over selection and management of the investment options and may delegate responsibilities to its executive director and external investment advisors. In accordance with RCW 41.50.088, the Employee Retirement Benefits Board (ERBB) makes recommendations to the WSIB on types of self-directed options, reflecting members' preferences. In accordance with RCW 41.34.130, the WSIB, after consultation with the ERBB on such recommendations, determines the investment options for the programs. The Department of Retirement Systems (DRS) has responsibility for program administration, investment accounting, participant record keeping, education, and communication.

The DCP is established under IRS Code Section 457. As such, the DCP is offered as a supplement to the employees' existing retirement plans. Participation is voluntary. As a tax deferred plan, participants select the amount they wish to contribute per pay period up to a maximum amount. Participants must also select and manage their asset allocation among the various investment options. Since the DCP is considered a retirement plan, the proper selection of options or asset allocation is critical for long-term growth of participant's funds.

Judicial Retirement Account (JRA)

The JRA is an Internal Revenue Code Section 401(a) retirement fund for state judges. The Administrative Office of the Courts (AOC) serves as trustee of the Fund. Through an interagency agreement, the AOC has requested that the WSIB provide investment management, investment oversight, and investment options for the Fund and perform certain trustee functions related to the assets. Through this agreement, the WSIB has authority over selection and management of the investment options and may delegate responsibilities to its executive director and external investment advisors. DRS has responsibility for program administration, investment accounting, participant record keeping, education, and communication.

As a 401(a) tax deferred plan, the JRA is offered as a retirement plan to employees. Participants select the amount they wish to contribute per pay period up to a maximum amount. Participants must also select and manage their asset allocation among the various investment options. Since the JRA Fund is a retirement plan, the proper selection of options or asset allocation is critical for long-term growth of the participant's funds.

PURPOSE:

This document outlines the investment policy for the assets of the DCP and JRA. It is designed to articulate the WSIB's investment objectives and risk tolerance for the investment options in accordance with RCW 43.33A.110. This document also formulates the Board's policies and guidelines on: (1) the number and type of options; (2) the investment style and strategy for each specific investment option; and (3) the process of prudently monitoring and evaluating the performance and risk of the investment options.

POLICY:

Standard of Care

Under RCW 41.50.780 and 43.33A.030, trusteeship of the DCP assets is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds and the JRA funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes investment decisions and seeks to meet the investment objectives listed below.

Investment Objectives

In accordance with RCW 43.33A.110, the investment objective of all assets under the control of the WSIB, which include the assets in the DCP and JRA, is to seek the maximum return at a prudent level of risk. The WSIB has a fiduciary duty to ensure that the DCP and JRA offer a balance of options to allow employees to build an asset allocation suitable for a range of participants from new employees to those in retirement. The investment options cover a broad spectrum of funds from low risk/low return to high risk/high return. The majority of the options offer participants the opportunity to seek long-term capital appreciation.

Based on this requirement the order of the objectives are:

1. Provide a diverse set of investment options to allow participants to invest their funds to maximize their future capital accumulation for retirement at their personal level of risk tolerance.
2. Provide an adequate number of options. The number of options should be broad enough to offer a comprehensive set of options, yet be limited in number to make the DCP and JRA easy to understand and offer the participant the ease of creating a diversified portfolio.

3. Minimize expenses to the participants.
4. Ensure that each investment option maintains its investment objectives and investment strategy as described to participants.
5. Provide investment options that do not compromise the participant's confidence in the program.

In keeping with these objectives and to offer an efficient and cost effective investment menu, it must be understood that not every participant's unique desire or request can be met. Participants' requests for specialized funds or highly focused investment strategies are best obtained through their own personal investments. This list of options is designed to provide the best menu of investment options for a broad group of participants and cannot be all things to each individual person.

Risk Constraint Standards

1. Invest the assets to maximize return at a prudent level of risk in accordance with the requirements of RCW 43.33A.110 and RCW 43.33A.140. Within each plan, the WSIB offers investment options that are suitable for long-term retirement investments for individuals.
2. Ensure that the stable value/money market option is invested in a manner to facilitate the maintenance of a one-dollar net asset value.
3. Ensure that each investment option is within its prescribed level of risk.

Investment Performance Objectives

Since each participant is responsible for the design and selection of their investment portfolio, the overall program does not have an aggregate investment performance objective. However, each investment option described below has a specific investment performance objective.

Asset Allocation and Investment Options

The WSIB offers the investment options listed below for the DCP and the JRA. The WSIB will adjust the investment management of the options as necessary.

Capital market conditions, management style of investment options, and investment performance are dynamic, not static. Consequently, the WSIB staff reviews the performance and management of the options with the ERBB quarterly. For those options managed internally by the WSIB, the Board has delegated to the executive director the authority to invest the funds according to the procedures established by the executive director pursuant to written policies and procedures.

Within the limit on the number of options, the WSIB strives to offer a comprehensive array of options including balanced life cycle funds and active and passive management styles.

Investment Options

<u>ASSET CLASS</u>	<u>STYLE</u>	<u>FUND</u>
Stable Value	Guaranteed Investment Contract (GIC) investments	Savings Pool
Fixed Income	Active intermediate bond	Bond Fund
Balanced	Balanced equity/debt	Socially Responsible Balanced Fund Washington State Horizon Funds: - Long-Horizon Fund - Mid-Horizon Fund - Short-Horizon Fund
U.S. Equities	Passive broad market index Passive small-cap index Active large-cap value Active large-cap core Active mid/large-cap growth	U.S. Stock Market Index Fund U.S. Small Stock Index Fund Equity Income Fund Core Equity Fund Growth Equity Fund
International Equity	Active international equity	International Equity Fund

Investment Options, Objective, and Style

Savings Pool

Objective: The Savings Pool seeks to protect principal while generating an income return in excess of short-term U.S. government securities. The fund is expected to maintain a one-dollar net asset value.

Strategy: The fund invests in high quality Guaranteed Investment Contracts issued by large insurance companies licensed to do business in the state of Washington. The Pool will seek a laddered maturity of contracts, not to exceed seven years, and maintain sufficient short-term liquidity to meet cash flow demands.

Benchmark: N/A

Bond Fund

Objective: The fund seeks a high level of current income. The fund is expected to meet or exceed the return of the Lehman Intermediate Credit index.

Strategy: The fund invests in investment grade rated U.S. and dollar denominated international fixed income instruments. The average portfolio maturity ranges between three to ten years.

Benchmark: Lehman Intermediate Credit Index

Socially Responsible Balanced Fund

Objective: A balanced fund that seeks long-term capital growth through an actively managed portfolio of stocks, bonds, and money market instruments consistent with certain social criteria established by the fund. The fund's one-year return should exceed the median return of a balanced fund peer group.

Strategy: The fund seeks to invest in a portfolio of companies that have demonstrated above average performance in a variety of social criteria. All holdings pass a broadly defined set of social screens, such as product safety and desirability, workplace issues, environmental impacts, international operations, and weapons contracting.

Benchmark: Custom blend – 55 percent S&P 500 Index and 45 percent Lehman Aggregate Index.

Washington State Horizon Funds

Long Horizon

Objective: A balanced fund managed for participants with a long investment horizon. The fund seeks to achieve a maximum long-term rate of return and accepts large fluctuations in the year-to-year returns. The fund has a target asset allocation that places the majority of the assets in U.S. and international equities with the remainder in U.S. fixed income.

Strategy: The fund invests passively in the broad indices that track the U.S. and the international equity markets plus an actively managed intermediate duration bond fund. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks approved by the Board.

Mid Horizon

Objective: A balanced fund managed for participants with a medium-term investment horizon. The fund seeks to achieve a maximum rate of return and accepts fluctuations in the year-to-year returns. The fund has a target asset allocation that places slightly more than half of the assets in U.S. and international equities with the remainder invested in U.S. fixed income.

Strategy: The fund invests passively in the broad indices that track the U.S. and the international equity markets plus an actively managed intermediate duration bond fund. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks approved by the Board.

Short Horizon

Objective: A balanced fund managed for participants with a short-term investment horizon. The fund seeks a more conservative rate of return but with some fluctuations in the volatility of the year-to-year returns. The fund has a target asset allocation that places a majority of the assets in lower risk and return bonds and in cash investments while still investing some of the assets in U.S. and international equities.

Strategy: The fund invests passively in the broad indices that track the U.S. and the international equity markets plus an actively managed intermediate duration bond fund and short-term cash investments. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks approved by the Board.

U.S. Stock Market Index Fund

Objective: Passively managed to approximate the return of the Dow Jones Wilshire 5000 index within a tracking error of 20 basis points annually.

Strategy: To approximate the characteristics and performance of the broad U.S. stock market.

Benchmark: Dow Jones Wilshire 5000 Index

U.S. Small Stock Index Fund

Objective: Passively managed to approximate the return of the Russell 2000 index.

Strategy: To approximate the characteristics and performance of the small-capitalization sector of the U.S. equity market.

Benchmark: Russell 2000 Index

Equity Income Fund

Objective: The fund seeks both reasonable income and capital appreciation. The fund should place in the top third of equity/income or value oriented large-capitalization portfolios.

Strategy: The fund invests at least 65 percent in income producing common and preferred stocks, including U.S. and international equities and fixed income.

Benchmark: Russell 3000 Value Index

Core Equity Fund

Objective: The fund seeks capital appreciation. The fund is expected to exceed the annualized return of the Russell 3000 Index and place in the top third of large-capitalization U.S. equity portfolios over a full market cycle.

Strategy: The fund invests primarily in large capitalized, well-established common stocks, including both U.S. and international equities.

Benchmark: Russell 3000 Index

Growth Equity Fund

Objective: The fund seeks capital appreciation. The fund is expected to exceed the annualized return of the Russell 3000 growth index and place in the top third of mid- to large-capitalization portfolios over a full market cycle.

Strategy: The fund invests in both U.S. and international equities that exhibit above average earnings growth potential.

Benchmark: Russell 3000 Growth Index

International Equity Index Fund

Objective: The fund seeks capital appreciation. The fund is expected to exceed the annualized return of the Morgan Stanley Capital International, Inc., Europe, Australia, Far East (MSCI EAFE) index and place in the top third of international equity portfolios over a full market cycle.

Strategy: The fund invests at least 65 percent in international securities, including international equities, convertible, and fixed income, from a minimum of three different countries.

Benchmark: MSCI EAFE Index

PERFORMANCE REVIEW GUIDELINES AND REPORTING:

Performance of the Horizon Funds, the Bond Market Fund, and the Savings Pool is reported by the WSIB staff. Since the WSIB does not perform investment fund accounting for these programs, the specific investment manager measures investment performance of the external options. The WSIB investment staff compiles and performs a quality check of the returns from the investment managers and reports quarterly to the Board and ERBB for each plan. The quarterly report identifies the distribution of the participant's assets among the various options for each plan and compares each option to its appropriate benchmark.

POLICY (IMPLEMENTATION):

The Board has established numerous policies and procedures for the investment staff to ensure consistent and efficient handling of the investment duties. The Board regularly reviews performance and costs of all funds under its control. On an annual basis, the Board reviews all the investment costs of the WSIB, including investment management and external service providers. Any direct costs related to the management of fund assets is deducted from the return of the various investment options. Additionally, under RCW 43.33A.160, the WSIB is allowed to deduct from the funds under its control the fund's proportional share of the WSIB's operating expenses, based on its assets under management.

RESPONSIBILITIES:

Washington State Investment Board - Responsible for approving the investment policy, setting the investment options, and reviewing the investment performance of the options.

Public Markets Committee - Responsible for reviewing and recommending the investment policy and investment options to the Board. Also responsible for reviewing the WSIB staff's investment management guidelines.

WSIB Staff - Responsible for direct management and daily pricing/unitization of the internally managed investment options; oversight, monitoring, and evaluating the external investment managers; and preparing and presenting the quarterly investment report. Additionally, responsible for recommending enhancements and changes to the investment policy and investment options to the Public Markets Committee and implementing the policy changes, managing the assets, and reporting performance and compliance to the policy (custody account management) to the Public Markets Committee, the ERBB, and the Board.

Employee Retirement Benefits Board – Responsible for consulting with the WSIB regarding recommendations for options for participants to choose for investment of the deferred portion of their income (RCW 41.34.130).

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